REQUEST THAT THE SUPREME COURT OF CALIFORNIA APPROVE AMENDMENTS TO RULE 3-310 OF THE RULES OF PROFESSIONAL CONDUCT OF THE STATE BAR OF CALIFORNIA, AND MEMORANDUM AND SUPPORTING DOCUMENTS IN EXPLANATION

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SUPPORTING DOCUMENTS

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I

RECOMMENDATION

The Board of Governors of the State Bar of California (hereinafter "Board") respectfully requests that this Court approve amendments to rule 3-310 (Avoiding the Representation of Adverse Interests) of the Rules of Professional Conduct of the State Bar of California in the form set forth in Enclosure 1.[1] A legislative style version of amended rule 3-310 showing proposed changes to the current rule is set forth in Enclosure 2.

Proposed amended rule 3-310 was adopted by the Board at its May 4, 2002 meeting. (The resolution adopted by the Board at its May 4, 2002 meeting is set forth in Enclosure 3.) Proposed amended rule 3-310 was developed in response to Business and Professions Code section 6068.11, requiring the State Bar to conduct a study, in consultation with representatives of the insurance defense bar, plaintiff's bar, the insurance industry and the Judicial Council, concerning the legal and professional responsibility conflict of interest issues arising from the decision of the California Court of Appeal in *State Farm Mutual Automobile Insurance Company v. Federal Insurance Company* (1999) 72 Cal.App.4th 1422 [86 Cal.Rptr.2d 20], rev. denied (9/29/99) (hereinafter "*State Farm*").

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[1] Business and Professions Code section 6076 provides: "With the approval of the Supreme Court, the Board of Governors may formulate and enforce rules of professional conduct for all members of the bar of this State."

Rules of Professional Conduct adopted by the Board are binding upon members of the State Bar only when approved by this Court. (See Business and Professions Code section 6077.)

Following study, the State Bar has determined that the essential issue presented by Business and Professions Code section 6068.11 is whether a lawyer owes a duty of loyalty to an insurance company client when the lawyer-client relationship with that insurance company arises from the handling of a defense matter for a policy holder of the insurance company. In consultation with the statutorily identified groups, the State Bar has concluded that under the holding of *State Farm*, the answer to this question is yes, provided the facts are that the defense lawyer is bringing a direct action against its insurance company client. However, in circumstances where the defense lawyer is not bringing a direct action against the insurance company but is instead bringing an action against another policy holder of the client insurance company, the *State Farm* holding should not be controlling because it can be distinguished on its facts. Based on its study, the State Bar believes that the intended application of rule 3-310 in such circumstances should be clarified.

The State Bar's proposal to amend rule 3-310 constitutes its response to the mandate of Section 6068.11 to the Business and Professions Code. The State Bar requests approval of a new Discussion section paragraph clarifying that subparagraph (C)(3) of rule 3-310 is not intended to subject an attorney to discipline when the lawyer-client relationship with an insurance company client arises from the handling of a defense matter for a policy holder of the insurance company such that the insurance company client's only interest is as an indemnity provider and not as a direct party to the action. A history and summary of the proposed amendments follow.

II

HISTORY OF THE FORMULATION OF PROPOSED AMENDMENTS TO RULE 3-310

A. Business and Professions Code section 6068.11

Effective January 1, 2001, the Legislature enacted Assembly Bill No. 2069 (hereinafter "AB 2069") adding Section 6068.11 to the Business and Professions Code (hereinafter "§6068.11"). This section directs the State Bar to conduct a study and consider recommendations for changes to the Rules of Professional Conduct in response to conflict of interest issues raised by the *State Farm* decision. In relevant part, §6068.11 specifically states:

> (a) The Legislature finds and declares that the opinion in *State Farm Mutual Auto Insurance Company v. Federal Insurance Company* (1999) 72 Cal. App. 4th 1422, raises issues concerning the relationship between an attorney and an insurer when the attorney is retained by the insurer to represent the insured. These issues involve both the Rules of Professional Conduct for attorneys and procedural issues affecting the conduct of litigation.
>
> (b) The board in consultation with representatives of associations representing the defense bar, the plaintiffs bar, the insurance industry and the Judicial Council, shall conduct a study concerning the legal and professional responsibility issues that may arise as a result of the relationship between an attorney and an insurer when the attorney is retained by the insurer to represent an insured, and subsequently, the

attorney is retained to represent a party against another party insured by the insurer. The board shall prepare a report that identifies and analyzes the issues and, if appropriate, provides recommendations for changes to the Rules of Professional Conduct and relevant statutes. The board shall submit the report to the Legislature and the Supreme Court of California on or before July 1, 2002.

(The full text of §6068.11 is set forth in Enclosure 4.)

B. Summary of the *State Farm* Decision

The Rules of Professional Conduct of the State Bar of California[2] are intended to regulate professional conduct of members of the State Bar through discipline (see, *e.g.*, paragraph (A) of rule 1-100). The rules are not intended to created civil causes of action and are not intended to impact any substantive legal duty of a member or the non-disciplinary consequences of violating such a duty. Notwithstanding this stated intent, civil courts apply the rules as non-disciplinary standards of attorney conduct in civil cases, for example, in motions to disqualify counsel in civil litigation matters. The decision in *State Farm* is one such occurrence. The following discussion summarizes the *State Farm* case. The full text of *State Farm* is set forth in Enclosure 5.

The situation in *State Farm* can be summarized as follows: Law Firm represented Insurance Company A in a coverage and declaratory relief action against Insurance Company B. At the same time, Law Firm represented an Insured of Insurance Company B

[2] Unless otherwise indicated, all further rule references are to the Rules of Professional Conduct of the State Bar of California.

in an unrelated insurance defense matter that eventually settled at mediation. While Law Firm was representing the Insured of Insurance Company B, Insurance Company B objected to Law Firm's the representation of Insurance Company A in the coverage case based on an asserted conflict of interest. Insurance Company B then brought a motion to disqualify Law Firm from the representation of Insurance Company A. The trial court found that disqualification was not required and Insurance Company B appealed. Citing to subparagraph (C)(3) of rule 3-310, the Fifth Appellate District of the California Court of Appeal held that the motion to disqualify Law Firm should have been granted, reasoning that absent the consent of Insurance Company A and Insurance Company B, the concurrent representation of clients, adverse in unrelated matters, was inconsistent with an attorney's duty of undivided loyalty.

Critical to the court's analysis was an explicit finding that, under California law, an attorney hired by an insurer to defend a third-party claim against the insurer's insured establishes an attorney-client relationship with both the insurer and its insured. Accordingly, the court in *State Farm* concluded that Insurance Company B was a client of Law Firm by virtue of the Law Firm's work in defending Insurance Company B's insured from a third-party claim. The court held that the duty of loyalty prohibited Law Firm from being adverse to Insurance Company B in the case brought against Insurance Company B by Insurance Company A, even though the "A v. B" case was unrelated to Law Firm's work in defending Insurance Company B's insured.

In stating its holding in *State Farm*, the court alluded to the concept that changes in existing law might be warranted. The court said:

> Thus, based on the established California principles that govern the attorney's relationship with the insurer who retains the attorney to defend the insured without asserting a reservation of rights, we hold that Federal [Insurance Company B] was McCormick's [Law Firm's] client for purposes of this disqualification motion. To hold otherwise would require an exception to existing law. Any such change, if warranted, should be made by either the Legislature or the California Supreme Court.

(*State Farm* at p. 1430.)

It appears that this language in the *State Farm* opinion served as the impetus for interested persons to seek the legislative action that resulted in AB 2069.

C. The Asserted Need for a Change in the Law

In sponsoring AB 2069, the California Defense Counsel has summarized its concern as follows:

> The holding presents enormous difficulties for defense counsel who may represent insureds from many different insurance companies. Defense counsel have always believed that no conflict arises from representing an insurer and also representing an insured from another company who may have a cross-complaint against an insured of the first company. "Conflicts checks" have not historically been performed for insurers who retain counsel on behalf of insureds, but only for insureds as defendants, and for insurers in cases of direct representation of the insurer as the defendant. Broadening

> conflicts analysis as required in State Farm v. Federal will be logistically burdensome and will require disqualification frequently for larger defense firms. Clients and insurers will ultimately be deprived of retaining counsel of their choice, even where no real conflict exists.

(AB 2069 -Bill Analysis, Senate Floor Analysis 8/22/00, at p. 2. A copy of the Senate Floor Analysis is set forth as Enclosure 6.)

An example cited by the proponent is the situation where defense counsel is retained by Insurance Company X to represent its insured in a case that requires a cross complaint against another party who is either another insured of Insurance Company X or is a policy holder of a different carrier that has retained the defense counsel in an unrelated case. In the latter situation, it is possible that a substitute defense counsel may be found who is not deemed to be in a lawyer-client relationship with the other carrier. However, the former situation is regarded as a "doomsday" scenario in which any attorney placed in that situation would be subject to a per se rule of disqualification under the reasoning in *State Farm*.

Additionally, it is asserted that conflicts checks systems cannot reasonably be expected to screen for adversity to the insureds of an insurer whom a lawyer represents. An attorney usually does not know who insures a potential defendant or cross-defendant before agreeing to represent a party seeking to sue the defendant or cross-defendant. Often the identity of such insurers is not discovered until a matter has substantially progressed. At that point, a disqualification motion may be unfair to the client who retained the lawyer, may subject the lawyer to unfair second-guessing for a conflict the lawyer could not reasonably avoid and may invite the abuse of disqualification motions for tactical purposes.

D. State Bar Study

At its October 2000 meeting and upon the recommendation of the Board Committee on Regulation and Discipline, the Board considered §6068.11 and referred the required study to its Committee on Professional Responsibility and Conduct (hereinafter "COPRAC"). The Board's resolution directed that with the input of the interested persons identified in the statute, COPRAC shall develop a report with recommendations regarding potential revisions to the rules and other relevant authorities to address the conflict of interest issues arising from the *State Farm* decision.

In response to the assignment from the Board, COPRAC established an AB 2069 Subcommittee to study conflicts of interest disqualification standards in the insurance defense context.[3] In addition, an informal Advisory Council was established to recognize the expertise and involvement of additional interested persons who were not specifically included in §6068.11. The AB 2069 Subcommittee and the Advisory Council held three day-long meetings and several smaller study group sessions and conference calls. Following its study, the AB 2069 Subcommittee reached a tentative consensus on a possible recommendation for action; however, upon final vote a consensus position was not achieved.

COPRAC reviewed the AB 2069 Subcommittee's study and came to the conclusion that any recommended solution required a threshold Board policy determination on the appropriate scope and breadth of the response to the §6068.11 mandate. COPRAC's Chair, Ellen R. Peck, reported COPRAC's conclusion to the Board at the Board's June 9,

[3] COPRAC member Sindee M. Smolowitz served as Chair of COPRAC's AB 2069 Subcommittee.

2001 meeting. (A copy of COPRAC's May 10, 2001 report, including the report of its AB 2069 Subcommittee, is set forth in Enclosure 7.) Together with COPRAC's report, the Board received presentations from representatives of the insurance industry and insurance defense counsel associations. Comments from insurance defense counsel representatives, in part, reflected the view that the *State Farm* decision and §6068.11 should be regarded as an invitation to the Board to address comprehensively a variety of potential issues raised by the *State Farm* decision and inherent in California's common law tripartite relationship among the insurance defense counsel, the insurer and the insured. In contrast, the comments from insurance industry representatives reflected the view that §6068.11 only required Board consideration of a narrow, technical conflict of interest issue which did not necessitate modification of California's long-standing common law tripartite relationship. (The views of the insurance defense representatives, the insurance industry representatives and the other interested persons are reported in COPRAC's AB 2069 Subcommittee Report provided as part of Enclosure 7.)

Following the COPRAC report and the comments from interested persons, the Board received a State Bar staff recommendation. State Bar staff recommended that the Board establish a joint task force of members of the Judicial Council, members of the Board, and other interested persons.[4] The Board agreed with the staff recommendation and a joint task force was appointed to evaluate the options for action identified by COPRAC and to

[4] State Bar staff also recommended that: (1) an extension be sought for the then July 1, 2001 deadline for the State Bar's report; and (2) the conflict of interest issues identified by COPRAC in its report be referred to the State Bar Office of the Chief Trial Counsel for its consideration in developing a written disciplinary enforcement policy addressing the exercise of prosecutorial discretion on complaints involving the potential violations of rule 3-310. Following the Board's action: (1) Senate Bill No. 958, enacted by the Legislature operative October 2, 2001, amended §6068.11 to state a July 1, 2002 deadline for completion of the State Bar's study; and (2) the State Bar Office of the Chief Trial Counsel developed Policy Directive 2001-4 to address the exercise of prosecutorial discretion in matters involving allegations of rule 3-310 violations in the context of §6068.11.

recommend a definitive course of action to be included in the Board's report to the Legislature and Supreme Court.

Consistent with the Board's action, State Bar staff worked with Judicial Council staff to implement the formation of a Joint Task Force of the Judicial Council and the State Bar on AB 2069 (hereinafter "Joint Task Force") to continue the study began by COPRAC. (A roster of the members of the Joint Task Force is set forth in Enclosure 8.)[5]

The Joint Task began its work by retaining a consultant, Professor J. Clark Kelso, to prepare a background paper on §6068.11 and *State Farm*. A paper was prepared and submitted to the Joint Task Force for consideration at its December 3, 2001 meeting. (The full text of the Background Paper, dated November 19, 2001, is set forth as Enclosure 9.) The Joint Task Force then discussed the precise issue raised by the *State Farm* case and the issues identified for study by §6068.11. As discussed in the consultant report, there is a "disconnect" between the precise issue upon which disqualification was predicated in *State Farm* and the issues identified for study in §6068.11. (See Enclosure 9, November 19, 2001, Background Paper at p. 2.) The consultant report observed on this point:

> It does not appear that any of the stakeholders seriously contends that the result in *State Farm* was incorrect under current law. There seems to be a consensus that a lawyer hired by an insurance company to represent an insured should not be permitted simultaneously to file a direct action against

[5] In forming the Joint Task Force, the interested persons identified in §6068.11 were self-selected by legislative representatives of each group, a COPRAC representative was invited to serve and two members each from the Board and the Judicial Council were selected. The Hon. Richard D. Aldrich, Associate Justice of the Court of Appeal, Second Appellate District, served as the Chair of the Joint Task Force.

> that insurance company even in an unrelated matter, absent written consent from both clients.
>
> It is important to note that even the language in AB 2069 does not question the result in *State Farm*. Instead, AB 2069 directed a study concerning issues that arise "when the attorney is retained by the insurer to represent an insured, and subsequently, the attorney is retained to represent a party against another party insured by the insurer." This was not the fact pattern before the court in *State Farm*.

(See Enclosure 9, November 19, 2001 Background Paper at p. 5.)

The concerns articulated by the insurance defense counsel proponents of §6068.11 appear to be that the decision in *State Farm* may be expanded by other courts to find disqualifying conflicts of interest in representation settings other than that addressed in *State Farm* and which would be of concern to insurance defense counsel. COPRAC made similar findings in its study. (See Enclosure 7, COPRAC's May 10, 2001 report at pp. 8-9.)

To address this issue of concern, the Joint Task Force decided to recommend that the State Bar consider recommending to this Court a proposed amendment to the Discussion section of rule 3-310.[6] The intended purpose of the proposed amendment would be to clarify that subparagraph (C)(3) of the rule is not intended to apply with respect to the relationship between an insurer and a lawyer when, in each matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action. The Joint Task

[6] Rule of Professional Conduct 1-100(C), in part, states that "the comments contained in the Discussions of the rules. . . are intended to provide guidance for interpreting the rules and practicing in compliance with them."

Force believed that this amendment would provide needed guidance to lawyers and the courts in applying rule 3-310, in light of the holding in *State Farm*. Specifically, it was discussed that if the proposed amended Discussion section was adopted by the Board and approved by this Court,[7] then it would be available to guide the State Bar Court in disciplinary matters, the State Bar Office of Enforcement in exercising prosecutorial decisions and civil courts in deciding disqualification motions and malpractice claims.[8]

The Joint Task Force also examined the other issues that had been raised with COPRAC and which were discussed in its report to the Board, including the concern that the California common law tripartite relationship that exists among the insured, the insurer and insurance defense counsel is a point of some controversy between representatives of the insurance industry and their defense counsel. After exploring these issues, it was determined that the Joint Task Force would narrow its recommendations to the precise conflict issue presented above leaving the broader policy considerations reflected in the tripartite relationship to the civil courts and the evolution of the civil law standard which created it.

Upon completion of the Joint Task Force study, State Bar staff reviewed the Joint Task Force proposal and recommended that the Board authorize a 90-day public comment distribution of the rule amendment that had been developed.

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[7] Rule Discussion sections are a part of the rules of professional conduct and amendments to discussion text requires this Court's approval. Business and Professions Code §6077, in part, provides that "[t]he rules of professional conduct adopted by the board, when approved by the Supreme Court, are binding upon all members of the State Bar."

[8] As previously noted, although the rules are not intended to define civil standards for disqualification of counsel, they are often used by the courts for this purpose.

At its January 25, 2002 meeting, the State Bar Board Committee on Regulation, Admissions and Discipline Oversight authorized a 90-day public comment distribution of proposed amended rule 3-310 which ended on April 29, 2002. (A copy of the State Bar's memorandum soliciting public comment as posted on the State Bar's internet website is set forth as Enclosure 10.) During this public comment period, a total of eleven written comments were received.[9] Of these eleven comments, ten generally support the proposal[10] and one generally opposes the proposal.[11]

Among the points raised in support of the State Bar's proposed rule amendment are the following: (1) the proposal is consistent with the body of case law which has long governed the tripartite relationship; (2) it is California's insureds who ultimately benefit from the proposal; (3) the amendment helps avoid the unnecessary conclusion that disqualification is required in dual third-party defense scenarios; (4) the proposal presents a rational and focused means of addressing a narrow concern; (5) the proposal is responsive to, and does not exceed, the AB 2069 charge of the Legislature codified in §6068.11; (6) the proposal is a reasonable and measured approach, which adequately responds to the concerns of defense counsel while preserving the well-established and time-honored relationship between insurance carriers and defense counsel; (7) attorneys retained to represent insured defendants in multi-party lawsuits frequently handle insurance defense

[9] A chart summarizing the written comments and a copy of the full text of the comments are set forth as Enclosure 11.

[10] These comments were from: Richard A. Zitrin; Ronald L. Coleman, Jr. (Los Angeles County Bar Association); James P. Wagoner (McCormick, Barstow, Sheppard, Wayte & Carruth LLP); G. Diane Colborn (Personal Insurance Federation of California); Marcus Baukol (Farmers Insurance Group); Peter Abrahams (Horvitz & Levy LLP); J. Donald Tierney (American International Companies); Bonnie R. Moss (Bonnie R. Moss & Associates, Employees of the Corporate Law Department of State Farm Mutual Automobile Insurance Co.); Samuel Sorich (National Association of Independent Insurers); and Eileen F. Braunreiter (California State Automobile Association Inter-Insurance Bureau).

[11] The comment was from Phillip Feldman.

matters for several of the insurers whose policyholders are named as defendants; (8) the proposed amendment strikes the proper balance between the duty of an attorney not to represent conflicting interests and the duty to properly represent his or her clients; (9) the proposal is necessary to enable insurers to select counsel of their choice -- lawyers with whom they have developed a successful working relationship and who are the best qualified and experienced to defend their insureds; (10) the proposal represents a fundamentally fair approach that will protect the interests of all parties to the tripartite relationship; (11) the proposed amendment clarifies that rule 3-310 is not intended to apply in situations where there is, in fact, no real potential conflict; (12) members of the defense bar welcome this proposal because many firms represent multiple insurers and because many insurers insure a large number of California businesses and it is virtually impossible to never run across an adverse party who happens to be insured by an insurer who also retains the firm in another matter; (13) the exception to the rule 3-310 requirement for client consent proposed by the amendment is a fair and thoughtful compromise (14) the seeds of this proposal grew out of the first AB 2069 study group and, at that time, the solution appeared to be acceptable to all who participated; and (15) the amendment will provide clear guidance and should be approved for that reason.

The comment in support from the Los Angeles County Bar Association suggested adding a final sentence to the proposed new Discussion section paragraph. The suggested language would state that no "conflict waiver" is required in circumstances where the insurer's only interest is as an indemnity provider but that a "conflict waiver" is required where the insurer is a direct party in an action. In considering this suggestion, the Board received State Bar staff input that the suggested language is not necessary and may be potentially confusing because it references the concept of a "conflict waiver." By its terms, rule 3-310 defines and requires "informed written consent" as a protocol to address certain

conflicts of interests. The concept of a "waiver" is not synonymous with "informed written consent" and may mislead attorneys as to what conduct is required under rule 3-310.

In another comment letter, attorney Richard Zitrin, in part, states that "the proposed modification of the discussion is helpful" but it "does not address two important issues related to insurance defense work." Mr. Zitrin's first issue involves a "Cumis counsel" conflict and an unpublished decision finding that disgorgement of legal fees was not required. His second issue involves concerns based on a defense counsel's role as an in-house employee of an insurance company.

In considering Mr. Zitrin's suggestions, the Board received State Bar staff input that both "Cumis counsel" status and the in-house employee status of a defense counsel are important considerations but that these variations go beyond the narrow facts of *State Farm* and the narrow issue identified by the Joint Task Force and COPRAC. State Bar staff observed that the possible unresolved status of apparent related issues should not be an obstacle to implementing a proposal that has garnered the support of the members of the Joint Task Force which includes representatives from: the insurance industry; insurance defense counsel associations; plaintiff's counsel (represented by the Consumer Attorneys of California); members of the Judicial Council; and members of the Board. State Bar staff emphasized that modification of the proposal to account for additional issues would place at risk the consensus reached by the representatives of these groups.

The letter opposing the proposed amendment is from attorney Phillip Feldman. In part, Mr. Feldman states that the proposal "is not instructive" and "begs the question in its entirety." Mr. Feldman also provides his own suggested Discussion section language to replace the State Bar's proposal. Among the points raised are the following: (1) *State Farm* was

simply a very poorly articulated case; (2) independent judgment requires that a lawyer unequivocally know who his or her client is; (3) no person or entity would utilize legal services in the absence of lawyer loyalty; (4) it is more probable than not that appellate and Supreme Court interpretations of rules in civil cases are binding upon the State Bar Court; (5) the common interests of insured and insurer against a claimant is the rule and conflicts between them are the exception; and (6) accepting compensation from an insurer may never interfere with an attorney's independence of professional judgement or with the client-lawyer relationship.

In considering Mr. Feldman's comment and his suggested Discussion section language, the Board received State Bar staff input that Mr. Feldman's comments and suggested replacement language included reference to, and reliance on, American Bar Association ("ABA") Model Rules. State Bar staff observed that the issue identified by both the Joint Task Force and COPRAC involves concepts peculiar to California common law and the California Rules of Professional Conduct and that the issue cannot be resolved appropriately by resorting to ABA authorities. However, State Bar staff also observed that Mr. Feldman's comments could be forwarded to the State Bar's Commission for the Revision of the Rules of Professional Conduct which is charged with studying the ABA Model Rules and considering possible comprehensive amendments that eliminate unnecessary differences with the ABA Model Rules.

At the Board's May 3-4, 2002 meetings and following consideration of the public comments received on proposed amended rule 3-310, the Board adopted proposed amended rule 3-310 for transmission to this Court with a recommendation that the proposed amended rule be approved. The next part of this memorandum provides a summary of proposed amended rule 3-310.

III

SUMMARY OF PROPOSED AMENDMENTS TO RULE 3-310

The proposal to amend rule 3-310 relates to the overarching concept of an attorney's duty of undivided loyalty. This summary begins with a brief survey of the duty of loyalty as it has developed in both the rules and in California common law.

A. The Duty of Loyalty in California

Over the years, California's concept of an attorney's duty of loyalty has been refined by evolutions in the common law and by modifications to the disciplinary rules. Broadly stated, an attorney's duty of loyalty means the faithful representation of the client's interest, including the exercise of professional independent judgment, protection of client confidential information and avoidance of conflicts of interest. Early on, an attorney's duty of loyalty, regarding avoidance of conflicts of interest, was described as follows:

> It is the general and well-settled rule that an attorney who has acted as such for one side cannot render services professionally in the same case to the other side, nor, in any event, whether it be in the same case or not, can he assume a position hostile to his client, and one inimical to the very interests he was engaged to protect; and it makes no difference, in this respect, whether the relation itself has been terminated, for the obligation of fidelity and loyalty still continues.

(*Wutchumna Water Co. v. Bailey* (1932) 216 Cal. 564 at page 572.) Since that early description, the articulation of the actual scope of this component of the duty of loyalty has

expanded and contracted with revisions to rule 3-310 (and its predecessors) and with the decisions of this Court.

The duty of loyalty is not limited to insurance law. Rather, it is a standard of professional responsibility generally applicable to all lawyers, regardless of their specialty. The duty of loyalty has been found to be implicated when a lawyer represents one client against another client. (See *Truck Ins. Exchange v. Fireman's Fund Ins. Co.* (1992) 6 Cal.App.4th 1050, 1056 [8 Cal.Rptr.2d 228]; *Jeffry v. Pounds* (1977) 67 Cal.App.3d 6, 10 [136 Cal.Rptr. 373]; *Civil Service Com. v. Superior Court* (1984) 163 Cal.App.3d 70, 78 [209 Cal.Rptr. 159].) However, the concept has not been limited to representations that were adverse to a client the lawyer then represents in other matters. It was applied when a lawyer represented multiple clients in the same matter whose interests conflicted. (See, e.g., *Buehler v. Sbardellati* (1995) 34 Cal.App.4th 1527, mod. at 35 Cal.App.4th 1212 [41 Cal.Rptr.2d 104].) It also applied when a lawyer represents a client against an adverse party and the lawyer accepts the representation of the adverse party while the representation of the preexisting client is still pending. (*Day v. Rosenthal* (1985) 170 Cal.App.3d 1125 [217 Cal.Rptr. 89].)

Of recent significance are this Court's decisions in *Flatt v. Superior Court* (1994) 9 Cal.4th 275 [36 Cal.Rptr.2d 537] (holding that the duty of loyalty prevents an attorney from giving legal advice to a client's prospective adversary in an unrelated matter) and in *Santa Clara County Counsel Attys. Assn. v. Woodside* (1994) 7 Cal.4th 525 [28 Cal.Rptr.2d 617] (holding that the duty of loyalty is not violated when publicly employed attorneys bring an action against a public entity client to enforce collective bargaining rights). Taken together, these two contemporaneous decisions underscore the malleable nature of the duty to account for public policy interests.

Regarding State Bar disciplinary standards, the rules have contained a prohibition against concurrent client conflicts for many years. Former rules 3-310(B), 5-102(B) and 7 prohibited lawyers from concurrently representing clients whose interests are adverse (in the case of former rule 3-310(B)), adverse interests (in the case of former rule 5-102(B)), or conflicting interests (in the case of former Rule 7) without the clients' informed written consent.

When rule 3-310 was revised in 1991, former rule 3-310(B) was deleted and replaced by rule 3-310(C)(2) and rule 3-310(C)(3). Rule 3-310(C)(2) requires informed written consent when a member represents in the same matter two or more clients whose interests actually conflict. Rule 3-310(C)(3) requires informed written consent when a member represents client A in a matter adverse to non-client B and B seeks to retain the lawyer in another matter while the representation of A against B is still pending. Although both of these rules are derived from principles embodied in former rule 3-310(B), neither addresses the representation of one client against a client represented by the lawyer in another matter.[12]

Recognizing that its revision of former rule 3-310(B) had resulted in the gap noted above, the Commission for the Revision of the Rules of Professional Conduct (hereinafter "Commission") developed a version of proposed rule 3-310(C)(4) when it revised the rest of rule 3-310 in 1991. As drafted at that time, proposed rule 3-310(C)(4) would have required informed written consent for a member to "accept employment in a matter by one client adverse to another party being represented by the member or the member's firm in

[12] Prior to 1991, as part of comprehensive rule amendments made operative in 1989, the new Discussion section to rule 3-310 included the following first sentence: "Rule 3-310 is not intended to prohibit a member from representing parties having antagonistic positions on the same legal question that has arisen in different cases, unless representation of either client would be adversely affected." This clarifying statement is another example of rule language that effectively limited the scope of the duty of loyalty for purposes of the disciplinary rule.

another matter, whether or not the matters are related." The proposed rule was developed late in the process and was not circulated for public comment. As a result, the Commission determined that it was imprudent to recommend the rule for approval at the time the rest of rule 3-310 was forwarded to the Board. However, in its report to the Board, the Commission stated its support for such an amendment to the rules.

Given the absence of rule 3-310(C)(4), in 1996 and through 1997, COPRAC developed a revised proposed new rule 3-310 (C)(4) to clarify the issue of a requirement for informed written consent when an attorney accepted or continued employment adverse to another current client in a wholly unrelated matter. The proposal prompted much comment and debate, particularly on the issue of transactional adversity and ultimately COPRAC terminated its effort due to a lack of consensus on the formulation of a rule.[13]

Case law, however, has not found rule 3-310 lacking as courts have cited rule 3-310(C)(3) as containing the rule 3-310(C)(4) component of the duty of loyalty. In particular, both *State Farm*, supra, at p. 1428 and *Flatt v. Superior Court* (1994) 9 Cal.4th 275, at pp. 282 and 296, fn. 4 suggest that rule 3-310(C)(3) addresses the component of the duty of loyalty that prohibits representation adverse to a current client on an unrelated matter.

In reviewing the duty of loyalty as implemented by rule 3-310, it was recognized that the basic, underlying purpose of the component of the duty of loyalty prohibiting representation adverse to a current client in an unrelated matter is to encourage a relationship of trust and confidence between attorney and client. Accordingly, if from the client's perspective it is determined that this relationship of trust and confidence is not threatened in a specific

[13] Other than authorizing public comment distributions of COPRAC's proposal, the Board did not take a position on the matter.

matter, then a violation of the duty of loyalty and the consequences that flow from that violation should not be found. The concept of informed written consent as a method to cure a conflict of interest reflects this policy.

The State Bar worked closely with interested persons in conducting both a COPRAC study and a Joint Task Force study that examined and appreciated the dynamics of the relationship between a defense lawyer and an insurance company client in the insurance defense context. The interested persons who participated were: the attorneys -- the insurance defense counsel association representatives; and the clients -- the insurance industry association representatives.[14] In addition to this perspective from inside the relevant lawyer-client relationship, an outside perspective was obtained from the plaintiff's bar (represented by the Consumer Attorneys of California) and the representatives from the Judicial Council and the Board. In consideration of these various positions, the State Bar found that in the insurance defense context it is possible to categorically define certain settings as situations where the component of the duty of loyalty prohibiting representation adverse to a current client in an unrelated matter may be deemed not to exist without placing at risk a client's trust and confidence and without harm to the public interest. The proposal to amend the Discussion section to rule 3-310 implements this conclusion.

[14] As noted in part I of this memorandum, the duty of loyalty issue raised by *State Farm* and §6068.11 pertains to an insurance defense counsel's duty to an insurance company client. No part of the State Bar's proposal is intended to abrogate a defense counsel's duty to an insured client. Accordingly, the precise language proposed for the rule 3-310 Discussion section refers to "the relationship between an insurer and a member."

B. The Proposed Amended Discussion Section to Rule 3-310

As adopted by the Board, the proposal to amend rule 3-310 would insert the following language in the rule 3-310 Discussion section between the current eighth and ninth Discussion section paragraphs:

> "In *State Farm Mutual Auto Insurance Company v. Federal Insurance Company* (1999) 72 Cal. App. 4th 1422, the court held that subparagraph (C)(3) was violated when a member, retained by an insurer to defend one suit, and while that suit was still pending, filed a direct action against the same insurer in an unrelated action without securing the insurer's consent. Notwithstanding *State Farm*, subparagraph (C)(3) is not intended to apply with respect to the relationship between an insurer and a member when, in each matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action."

The first sentence of the proposed new Discussion section paragraph is intended to make clear that the *State Farm* holding on subparagraph (C)(3) of rule 3-310 occurred in a specific and narrow fact setting. Specially, it identifies that the fact setting involved a member's direct action against an insurer client without having first obtained the insurer's informed consent. Nothing in the State Bar's proposal is intended to suggest that *State Farm* was wrongly decided given the specific facts of the case.

The second sentence of the proposed new Discussion section paragraph is intended to clarify that the rationale of the *State Farm* holding should not be construed to mean that subparagraph (C)(3) of rule 3-310 is violated in an identified fact setting that is similar but

not identical to the fact setting in *State Farm*. Specifically, that fact setting is one where there is no direct action against an insurer client and the insurer client's only interest is that of an indemnity provider.

Finally, it should be noted that current rule 3-310 includes Discussion language that clarifies the application of the rule to an insurance defense setting. That language is the last paragraph of the Discussion section which, in part, states: "Paragraph (F) [regarding fees paid by a person other than the client] is not intended to abrogate existing relationships between insurers and insureds whereby the insurer has the contractual right to unilaterally select counsel for the insured, where there is no conflict of interests." Like the State Bar's present proposal, this language addresses a specific relationship in the insurance defense context and clarifies the intended limited applicability of the rule. Thus, there is precedent for the State Bar's instant proposal to amend the rule 3-310 Discussion section.

IV

CONCLUSION

The Board of Governors of the State Bar of California respectfully requests that this Court approve the proposed amendments to rule 3-310 (Avoiding the Representation of Adverse Interests) of the Rules of Professional Conduct of the State Bar of California in the form set forth in Enclosure 1.

ENCLOSURE 1:

Proposed Amended Rule 3-310 of the Rules of Professional Conduct of the State Bar of California

Rule 3-310. Avoiding the Representation of Adverse Interests.

(A) For purposes of this rule:

(1) "Disclosure" means informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client;

(2) "Informed written consent" means the client's or former client's written agreement to the representation following written disclosure;

(3) "Written" means any writing as defined in Evidence Code section 250.

(B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:

(1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; or

(2) The member knows or reasonably should know that:

(a) the member previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; and

(b) the previous relationship would substantially affect the member's representation; or

(3) The member has or had a legal, business, financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by the resolution of the matter; or

(4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.

(C) A member shall not, without the informed written consent of each client:

(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or

(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or

(3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.

(D) A member who represents two or more clients shall not enter into an aggregate settlement of the claims of or against the clients, without the informed written consent of each client.

(E) A member shall not, without the informed written consent of the client or former client, accept employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment.

(F) A member shall not accept compensation for representing a client from one other than the client unless:

(1) There is no interference with the member's independence of professional judgment or with the client-lawyer relationship; and

(2) Information relating to representation of the client is protected as required by Business and Professions Code section 6068, subdivision (e); and

(3) The member obtains the client's informed written consent, provided that no disclosure or consent is required if:

(a) such nondisclosure is otherwise authorized by law, or

(b) the member is rendering legal services on behalf of any public agency which provides legal services to other public agencies or the public.

Discussion:

Rule 3-310 is not intended to prohibit a member from representing parties having antagonistic positions on the same legal question that has arisen in different cases, unless representation of either client would be adversely affected.

Other rules and laws may preclude making adequate disclosure under this rule. If such disclosure is precluded, informed written consent is likewise precluded. (See, e.g., Business and Professions Code section 6068, subsection (e).)

Paragraph (B) is not intended to apply to the relationship of a member to another party's lawyer. Such relationships are governed by rule 3-320.

Paragraph (B) is not intended to require either the disclosure of the new engagement to a former client or the consent of the former client to the new engagement. However, both disclosure and consent are required if paragraph (E) applies.

While paragraph (B) deals with the issues of adequate disclosure to the present client or clients of the member's present or past relationships to other parties or witnesses or present interest in

the subject matter of the representation, paragraph (E) is intended to protect the confidences of another present or former client. These two paragraphs are to apply as complementary provisions.

Paragraph (B) is intended to apply only to a member's own relationships or interests, unless the member knows that a partner or associate in the same firm as the member has or had a relationship with another party or witness or has or had an interest in the subject matter of the representation.

Subparagraphs (C)(1) and (C)(2) are intended to apply to all types of legal employment, including the concurrent representation of multiple parties in litigation or in a single transaction or in some other common enterprise or legal relationship. Examples of the latter include the formation of a partnership for several partners or a corporation for several shareholders, the preparation of an ante-nuptial agreement, or joint or reciprocal wills for a husband and wife, or the resolution of an "uncontested" marital dissolution. In such situations, for the sake of convenience or economy, the parties may well prefer to employ a single counsel, but a member must disclose the potential adverse aspects of such multiple representation (e.g., Evid. Code, §962) and must obtain the informed written consent of the clients thereto pursuant to subparagraph (C)(1). Moreover, if the potential adversity should become actual, the member must obtain the further informed written consent of the clients pursuant to subparagraph (C)(2).

Subparagraph (C)(3) is intended to apply to representations of clients in both litigation and transactional matters.

In *State Farm Mutual Automobile Insurance Company v. Federal Insurance Company* (1999) 72 Cal.App. 4th 1422 [86 Cal.Rptr.2d 20], the court held that subparagraph (C)(3) was violated when a member, retained by an insurer to defend one suit, and while that suit was still pending, filed a direct action against the same insurer in an unrelated action without securing the insurer's consent. Notwithstanding *State Farm*, subparagraph (C)(3) is not intended to apply with respect to the relationship between an insurer and a member when, in each matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action.

There are some matters in which the conflicts are such that written consent may not suffice for non-disciplinary purposes. (See Woods v. Superior Court (1983) 149 Cal.App.3d 931 [197 Cal.Rptr. 185]; Klemm v. Superior Court (1977) 75 Cal.App.3d 893 [142 Cal.Rptr. 509]; Ishmael v. Millington (1966) 241 Cal.App.2d 520 [50 Cal.Rptr. 592].)

Paragraph (D) is not intended to apply to class action settlements subject to court approval.

Paragraph (F) is not intended to abrogate existing relationships between insurers and insureds whereby the insurer has the contractual right to unilaterally select counsel for the insured, where there is no conflict of interest. (See San Diego Navy Federal Credit Union v. Cumis Insurance Society (1984) 162 Cal.App.3d 358 [208 Cal.Rptr. 494].)

ENCLOSURE 2:

Rule 3-310 Showing Proposed Amendments in Legislative Style

Rule 3-310. Avoiding the Representation of Adverse Interests.

(A) For purposes of this rule:

(1) "Disclosure" means informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client;

(2) "Informed written consent" means the client's or former client's written agreement to the representation following written disclosure;

(3) "Written" means any writing as defined in Evidence Code section 250.

(B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:

(1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; or

(2) The member knows or reasonably should know that:

(a) the member previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter; and

(b) the previous relationship would substantially affect the member's representation; or

(3) The member has or had a legal, business, financial, professional, or personal relationship with another person or entity the member knows or reasonably should know would be affected substantially by the resolution of the matter; or

(4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.

(C) A member shall not, without the informed written consent of each client:

(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or

(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or

(3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.

(D) A member who represents two or more clients shall not enter into an aggregate settlement of the claims of or against the clients, without the informed written consent of each client.

(E) A member shall not, without the informed written consent of the client or former client, accept employment adverse to the client or former client where, by reason of the representation of the client or former client, the member has obtained confidential information material to the employment.

(F) A member shall not accept compensation for representing a client from one other than the client unless:

(1) There is no interference with the member's independence of professional judgment or with the client-lawyer relationship; and

(2) Information relating to representation of the client is protected as required by Business and Professions Code section 6068, subdivision (e); and

(3) The member obtains the client's informed written consent, provided that no disclosure or consent is required if:

(a) such nondisclosure is otherwise authorized by law, or

(b) the member is rendering legal services on behalf of any public agency which provides legal services to other public agencies or the public.

Discussion:

Rule 3-310 is not intended to prohibit a member from representing parties having antagonistic positions on the same legal question that has arisen in different cases, unless representation of either client would be adversely affected.

Other rules and laws may preclude making adequate disclosure under this rule. If such disclosure is precluded, informed written consent is likewise precluded. (See, e.g., Business and Professions Code section 6068, subsection (e).)

Paragraph (B) is not intended to apply to the relationship of a member to another party's lawyer. Such relationships are governed by rule 3-320.

Paragraph (B) is not intended to require either the disclosure of the new engagement to a former client or the consent of the former client to the new engagement. However, both disclosure and consent are required if paragraph (E) applies.

While paragraph (B) deals with the issues of adequate disclosure to the present client or clients of the member's present or past relationships to other parties or witnesses or present interest in the subject matter of the representation, paragraph (E) is intended to protect the confidences of another present or former client. These two paragraphs are to apply as complementary provisions.

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Subparagraphs (C)(1) and (C)(2) are intended to apply to all types of legal employment, including the concurrent representation of multiple parties in litigation or in a single transaction or in some other common enterprise or legal relationship. Examples of the latter include the formation of a partnership for several partners or a corporation for several shareholders, the preparation of an ante-nuptial agreement, or joint or reciprocal wills for a husband and wife, or the resolution of an "uncontested" marital dissolution. In such situations, for the sake of convenience or economy, the parties may well prefer to employ a single counsel, but a member must disclose the potential adverse aspects of such multiple representation (e.g., Evid. Code, §962) and must obtain the informed written consent of the clients thereto pursuant to subparagraph (C)(1). Moreover, if the potential adversity should become actual, the member must obtain the further informed written consent of the clients pursuant to subparagraph (C)(2).

Subparagraph (C)(3) is intended to apply to representations of clients in both litigation and transactional matters.

In *State Farm Mutual Automobile Insurance Company v. Federal Insurance Company* (1999) 72 Cal.App. 4th 1422 [86 Cal.Rptr.2d 20], the court held that subparagraph (C)(3) was violated when a member, retained by an insurer to defend one suit, and while that suit was still pending, filed a direct action against the same insurer in an unrelated action without securing the insurer's consent. Notwithstanding *State Farm*, subparagraph (C)(3) is not intended to apply with respect to the relationship between an insurer and a member when, in each matter, the insurer's interest is only as an indemnity provider and not as a direct party to the action.

There are some matters in which the conflicts are such that written consent may not suffice for non-disciplinary purposes. (See Woods v. Superior Court (1983) 149 Cal.App.3d 931 [197 Cal.Rptr.

185]; Klemm v. Superior Court (1977) 75 Cal.App.3d 893 [142 Cal.Rptr. 509]; Ishmael v. Millington (1966) 241 Cal.App.2d 520 [50 Cal.Rptr. 592].)

Paragraph (D) is not intended to apply to class action settlements subject to court approval.

Paragraph (F) is not intended to abrogate existing relationships between insurers and insureds whereby the insurer has the contractual right to unilaterally select counsel for the insured, where there is no conflict of interest. (See San Diego Navy Federal Credit Union v. Cumis Insurance Society (1984) 162 Cal.App.3d 358 [208 Cal.Rptr. 494].)